WHAT FOREST LANDOWNERS SHOULD KNOW ABOUT FEDERAL ESTATE AND GIFT TAXES

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CONTENTS

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WHAT FOREST LANDOWNERS SHOULD KNOW ABOUT FEDERAL ESTATE AND GIFT TAXES

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WHAT DOES THE 1976 TAX REFORM ACT MEAN TO YOU?

Plenty! It means good news to some and bad news to others. Changes in Federal estate
and gift tax laws can affect your plans for transferring forest property to your spouse, children
or other heirs. Chances are that no Federal estate tax will be due on estates valued at less than
1 $425,625 when left to a surviving spouse after 1980. But for most of those in higher brackets,
the tax will be more than before. This brochure provides guidelines that apply in the period
before 1980, as well as in subsequent years. For forest landowners, the new provisions mean
lower estate taxes in many cases, but higher capital gains taxes if the heirs sell the property.

The information in this folder is of a general nature and will apply in most situations. In some specific cases, however, there may be exceptions. Contact a tax specialist if you have any quesitons. The Internal Revenue Service (IRS) also may be able to provide information that pertains to your situation. The authors are unable to provide detailed assistance to individuals, but they will be glad to help you contact the appropriate State or Federal office if you cannot locate the one closest to you.

LATE BULLETIN

CARRYOVER BASIS

Since going to press, the effective date of the carryover basis provision described on Page 7 has been delayed by Congress until January 1, 1980. However, Congress has not yet authorized any adjustment for those estates filing between January 1, 1977, and the enactment of the new 1978 legislation. Congress has promised to consider the problem of these estates early in 1979.

UNIFIED CREDIT

BEFORE . . . . NOW

Heirs were granted exemptions which were subtracted before the estate or lifetime gift was taxed. The basic exemptions were $60,000 for estate transfers and $30,000 for lifetime gifts.

Year	*Unified credit*	*Estate and gift tax exemption equivalent*
1978	$34,000	$134,000
1979	38,000	147,333
1980	42,500	161,563
1981 and thereafter	47,000	175,625

Instead of an exemption, heirs are granted a single unified tax credit which applies to both lifetime gifts and estates. This credit is being phased in over a 5-year period. The tax credit is subtracted after the total tax has been computed. For purposes of comparison, however, the new provisions grant an equivalent of the exemptions shown in the table.

Because of the unified nature of the credit, it will be reduced as it is applied to taxes on lifetime gifts. Only the unused portion remaining at the taxpayer's death is available as a credit against the estate tax.

UNIFIED TAX RATE

BEFORE . . . . NOW

Estate taxes were treated separately from gift taxes. A graduated tax of 3 to 77 percent was levied on the taxable estate. The gift tax rate was three-fourths that of the estate tax.

The rate is the same for gift and estate taxes: 18 to 70 percent. This effective range is narrowed to 32 to 70 percent starting in 1981. Taxes at the 18 to 30 percent rates will be offset at that time by the $47,000 unified credit.

MARITAL DEDUCTION

ESTATES

BEFORE . . . . NOW

The maximum marital deduction for property passing in an estate to a surviving spouse tax free was limited to 50 percent of the adjusted gross estate.

The marital deduction has been increased to the greater of $250,000 or 50 percent of the decedent's adjusted gross estate. When the marital deduction on a $300,000 adjusted gross estate would have been $150,000 ($300,000 x .5) under the old law, it is now $250,000.

GIFTS

BEFORE . . . . NOW

The maximum marital deduction for property passing by lifetime gift to a spouse tax free was limited to 50 percent of the fair market value of the gift regardless of the amounts involved.

No tax (unlimited deduction) is levied on the first $100,000 of lifetime gifts between spouses. The second $100,000 is fully taxed. Half of the amount over $200,000 is exempt from tax.

GIFTS, continued

BEFORE . . . . NOW

The gift tax marital deduction did not offset the estate tax marital deduction.

Lifetime gifts of less than $200,000 will result in a gift tax marital deduction of more than 50 percent. The estate tax marital deduction will be reduced by the excess over 50 percent.

5

LIFETIME GIFTS

BEFORE . . . . NOW

Once during a lifetime, a person could give a total of $30,000 as a gift to one person or split it among many people; this amount was exempt from the gift tax.

This provision is no longer available.

LIFETIME GIFTS, continued

BEFORE . . . . NOW

A person could give $3,000 per year per person, up to time of death, with no taxes, if death was unexpected. If such gifts were made within 3 years before death, and death was **expected,** the exemptions did not apply. Such gifts became part of the estate.

A person can give $3,000 per year, per person, up to time of death, with no tax payable, and with no questions asked.

BEFORE . . . . NOW

Gifts, both taxed and nontaxed, were not considered part of the estate, except those made within 3 years of an expected death.

Gifts not taxed are still not considered part of the estate except those made under the marital deduction within 3 years of death. Other distinctions are made between taxed and nontaxed gifts, and between those made within 3 years of death and earlier.

CHANGE IN CARRYOVER BASIS

BEFORE . . . . NOW

When an heir sold inherited property, increases in value before the decedent's death were not taxed.

Capital gains must be paid on any increase in the value of the property minus adjustments, since its original acquisition by the decedent. This rule does not apply, however, to any increase in the value before December 31, 1976. Any gain after that date is subject to income tax. See the example below.

7 **Example.**—Joe Jones purchased a small tree farm on April 6, 1974. At that time, timber on the farm was valued at $80,000—its original basis. At the time of his death on May 15, 1978, the timber had a fair market value of $120,000. Jones owned the timber for 1,500 days. One thousand of these days occurred before December 31, 1976, and five hundred days thereafter. Disregarding certain possible adjustments to the carryover basis, there would be a $40,000 gain in timber value ($120,000 - $80,000). Two thirds (1,000 ÷ 1,500 days) or $26,667 would not be taxed if the timber is sold by Jones' heirs for $120,000, while one-third (500 ÷ 1,500 days) or $13,333 would be taxed.

Various modifications soften these rules somewhat. One modification permits an executor to exclude $10,000 of personal or household effects. Also, the basis of certain property can be increased by Federal and State death taxes attributable to the property's net gain in value. Further, the combined basis of all property in the estate can be stepped up to $60,000 in certain cases.

Special Provisions for Forest Landowners

For the first time, farm and forest landowners are given special consideration for tax purposes. **The timberland part of an estate no longer has to be valued at its "highest and best use" for estate tax purposes.** When an estate is probated, timberland can now be valued on what it's worth for growing timber instead of its fair market value or speculative value. This new provision could save the estate thousand of dollars in taxes. And what's more, it could insure that timber will not be liquidated or cut prematurely to pay death taxes, thus allowing a good forest management program to continue.

Requirements

1. The timberland must have been owned by the decedent or a member of the family for at least five of the last eight years before the decedent's death.
2. During at least five years of such ownership, the property must have been used and managed for timber growing purposes.
3. The decedent, or a member of the family, must have materially participated in the management of the timber operation for at least five years out of the last eight immediately before the decedent's death.

   Note: Family members include parents, grandparents, brothers and sisters and their spouses, children and their spouses, grandchildren and their spouses, husbands, wives, uncles and aunts by both blood and marriage, cousins and their spouses and nieces and nephews and their spouses.

4. All use valuations taken together (forest land and timber, farms and other qualifying property) cannot reduce the fair market value of the gross estate by more than $500,000.

5. The total of all the real and personal property that qualifies for use valuation in an estate must, when valued at its highest and best use, be at least half of the estate's adjusted gross value.

6. Real property (land, timber, or buildings) eligible for use valuation must, when valued at highest and best use, represent at least one-fourth of the estate's adjusted gross value. Personal property associated with the land and eligible for use valuation, such as machinery and equipment, may not be included in this total.

7. The property must pass to a qualified heir or heirs. These persons include the same family members listed above.

8. An agreement for use valuation must be signed by all persons who have inherited an
9 interest in the forest land. The agreement must then be filed within the same time limit required for filing a Federal estate tax return.

9. For the agreement to remain valid, the following requirements must be met for 15 years after the death of the decedent:

A. Ownership must continue solely within the decedent's family.

B. At least one member of the decedent's family must materially participate in management of the property during 5 of every 8 years.

C. During at least 5 of every 8 years, the property must be used and managed for timber growing purposes.

10. If forest management is discontinued or the property converted to another use within 10 years, all taxes saved by the use valuation must be paid. The penalty is lessened somewhat if the change occurs between 10 to 15 years.

Time Extensions

If the forest property can meet the IRS definition of a "trade or business," certain time extensions can automatically be claimed for paying the estate tax on this property. If the property is more than 35 percent of the gross estate or 50 percent of the taxable estate, the tax can be paid in up to ten equal annual installments. If the property is more than 65 percent of the adjusted gross estate, payment of the tax can be deferred for up to five years and then paid in up to ten annual installments.

If the property does not qualify as a "trade or business," or does not meet one of the percentage tests, the IRS may still give permission for the tax to be paid in up to ten equal annual installments upon a showing of reasonable cause.

CONCLUSION

The 1976 Tax Reform Act wrought significant changes that can affect your estate. Consult knowledgeable estate planning professionals, such as attorneys, certified public accountants, trust officers, and insurance specialists to insure that your estate plans, wills, insurance coverage, and other estate planning tools take account of the new changes in the law.

DEFINITIONS

Adjusted gross estate.—The gross estate less the deduction allowed for funeral expenses, administration expenses, and debts of the deceased.

Basis.—The value that is used to determine a gain or loss for income tax purposes upon the sale of property.

Capital gain.—The difference between the purchase price or other basis of a capital asset and its selling price.

Estate.—All real and personal property owned by a person.

Estate tax.—Death tax levied on an estate before distribution to the heirs.

Executor.—A man appointed in a will to carry out the directions of the deceased and to dispose of the property. The female counterpart is called an **executrix**.

11 **Exemption.**—An amount deducted from the adjusted gross estate to arrive at the taxable estate.

Fair market value.—The price a willing buyer will pay a willing seller, both reasonably informed of the facts and without undue pressure to buy or sell.

Gross estate.—The total value of all property owned by the decedent at the time of death.

Material Participation.—As of this printing, the term has not been fully defined. However, the IRS has **proposed** the following criteria: If management is less than on a full time basis, there would have to be a regular process of consultation and inspection, with active involvement in making management decisions; financial participation in management of the

property would be required; and agents or employees could not act as a substitute for the owner unless they were also family members.

Tax credit.—An allowance to offset taxes payable.

Taxable estate.—Adjusted gross estate less marital and charitable deductions.

Unified tax credit.—A single tax credit applied to both gift and estate taxes.

Use valuation.—Value based on actual use rather than the highest and best use.

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